Office of the Attorney General
Washington, D. C. 20530

May 14, 1982

Mr. J. Jackson Walter
Director
Office of Government Ethics
Office of Personnel Management
1900 E Street, N.W. - Room 436H
Washington, D.C. 20415

Dear Mr. Walter:

Following our conversation this afternoon when the supplemental disclosure information set forth in Mr. Giuliani's letter of this date was transmitted to your office, I have identified additional information with respect to Mr. Smith's previous service on the Board of Directors of the Earle M. Jorgensen Company ("the Company") which may be of relevance to your Office in the review of Mr. Smith's Financial Disclosure Report dated May 7, 1982.

As indicated in Mr. Giuliani's letter of today, Mr. Smith served on the Board of Directors of the Company, a publicly held company whose securities are listed on the New York Stock Exchange, since 1975. He served in the position of an outside director. He was at no time an officer or employee of the Company. In addition, since 1978 Mr. Smith served as a member of the Company's Audit Committee, which consisted of three outside directors. Mr. Smith was the only lawyer-member of that Committee during his tenure. He was a member of the Audit Committee at the time of his resignation from the Board on January 12, 1981, prior to his confirmation hearings before the Senate Judiciary Committee. During this period of service Mr. Smith assumed responsibility for various special projects. As you know, particular responsibilities are vested in the Audit Committees of the boards of directors of publicly held companies which are subject to the reporting requirements of the Securities and Exchange Act of 1934.

The determination by the Board to compensate Mr. Smith for his prior services was, as indicated in Mr. Giuliani's letter, embodied in a resolution which states expressly that the payment was made "for his [Mr. Smith's] loyal and dedicated past service to the company as a member of its Board of Directors and Audit Committee." The minutes of the Board meeting, which are attached to Mr. Giuliani's letter,

refer expressly to Mr. Smith's "years of dedicated and loyal past service." There is no indication or suggestion whatever that the payment was intended or designed to compensate Mr. Smith for any future services that he might render as an officer of the United States Government.

Under existing federal statutes it is impermissible for any entity or person to pay, or for an individual to receive, any contribution to or supplementation of salary as compensation for the individual's services as an officer or employee of the Executive Branch. The operative provision in this respect is 18 U.S.C. 209.

Title 18, Section 209(a) provides, in part:

> "Whoever receives any salary, or any contribution to or supplementation of salary, as compensation for his services as an officer or employee of the executive branch of the United States, or of the District of Columbia, from any source other than the Government of the United States, except as may be contributed out of the treasury of any State, county, or municipality; ...
>
> Shall be fined not more than $5,000 or imprisoned not more than one year, or both."

The initial issue is whether the compensation in question is "compensation for...services as an officer" of the United States government. "The statutory objection is not to the outside income, but to the linkage between the income and the performance of official duties." Manning, Federal Conflict of Interest Law 146 (1964). As Manning has written, "payments to a government employee 'for' past services ... are permissible so far as [the statute] is concerned." Id., at 166.

It is well established that the critical factor in determining whether a payment was for services as a government official is the intent of the parties to the transaction. "[T]he determination of whether a particular payment is made 'in connection with' the services of an individual as a Government official or employee is often a matter of ascertaining not only the intent with which the payment is made but also the intent of the employee in receiving the payment." 41 Op., Atty. Gen. 217, 221 (1955).

The evil at which the statutory prohibition is directed is the government employee who is serving two masters: the government and the private concern paying him a supplemental salary for the same services. "The rule is really a special case of the general injunction against serving two masters." Association of the bar of the City of New York, Conflict of

Interest and Federal Service 211 (1960). "The purpose is to prevent an outside source from diluting an official's loyalty by paying him on the side to do what the government has already hired him to do." Manning, supra, at 146. See also 33 Op. Atty. Gen. 273, 275 (1922).

The origins of section 209 are distinct from the origins of the provisions of the Ethics in Government Act. Section 209 derives from 18 U.S.C. 1914, enacted in 1917. Section 1914 grew out of objections to certain government employees receiving their remuneration from private sources with an interest in the governmental duties performed by the employees. Specifically, the Bureau of Education of the Department of Interior had entered into an arrangement with certain private educational foundations whereby certain employees of the Bureau, performing government functions, were paid only a dollar per year by the government and received their real salaries from the foundations. "In some quarters these arrangements aroused fear that the foundations were wielding a new and noxious influence on national educational policy." Manning, supra, at 148. A bill introduced to combat this specific problem was broadened to become 18 U.S.C. 1914, which with slight changes became 18 U.S.C. 209.

Section 209 changed the language of its predecessor 18 U.S.C. 1914 in such a manner as to stress the need for a clear link between the payment and the rendition of government services to establish a violation of the statute. 18 U.S.C. 1914 prohibited payments "in connection with" government services. This was amended to the present language prohibiting outside payments "as compensation for" the services. As the House Report stated:

> Whereas the prohibition of section 1914 applies to private salary paid "in connection with" the Government services of the employee, section 209 substitutes the phrase "as compensation for" his services as an officer or employee in order to emphasize the intent that the prohibition is against private payment made expressly for services rendered to the Government. The phrase "in connection with" is vague and capable of an indefinitely broad interpretation. H.R. Rep. No. 748, 87th Cong., 1st Sess. 24 (1961).

Manning noted that the change in statutory language "is a step toward further specifying that the outside salary payments are not illegal unless directly linked to the employee's governmental services." Supra, at 171.

It is evident from the historic purpose behind the statute -- to prevent a government employee from serving two

masters and being swayed in the performance of his official duties by receipt of compensation from non-government sources --that this prohibition was not intended to prevent a payment for past services, such as the severance payment from the Company to Mr. Smith. Indeed, it is beyond dispute that compensation for prior services is outside the ambit of statutory coverage. As noted in a recent article, "[r]ewards for past services are of course acceptable [under the federal conflict of interest laws]." Walter, The Ethics in Government Act, Conflict of Interest Laws and Presidential Recruiting, Public Administration Review (November-December 1981). The materials for the 1981 Office of Government Ethics Conference state that "[a]cceptance of a severance payment from a former employer in consideration of the recipient's past services" is not within the prohibition of section 209.

The fact that the payment was intended by the Board as severance pay is further suggested by the manner in which the compensation was paid. No installment arrangement was entered into so as to continue payments while Mr. Smith was in federal service. To the contrary, the payment was made in one lump sum payment at the conclusion of Mr. Smith's service on the Board and was presented to him at the board meeting itself on January 12, 1981, following the Board's unanimous adoption of the foregoing resolution. As indicated by former Assistant Attorney General Antonin Scalia of the Office of Legal Counsel, "A lump sum payment made upon transition from private to Federal employment is less indicative of compensation for Federal employment than are periodic payments made while the Federal employment continues." Office of Legal Counsel Memorandum of January 22, 1975, at p. 2.

In addition, the Board, as previously indicated, expressly noted in its discussion as reflected in the minutes Mr. Smith's long tenure on the Board. A lump sum payment was the vehicle chosen by the Board as compensation for those services, rendered by an outside director over a period of approximately six years without any other form of compensation from the Company than directors fees. Moreover, the directors fees paid to Mr. Smith, as an outside director who derived no other earned income from the Company, were modest in amount in comparison to fees paid by other boards on which Mr. Smith had served.

Moreover, it is of particular relevance that Mr. Smith, as noted above, was at no time an employee of the Company. (Since no employment relationship existed, there was no occasion for the Company, as we understand it, to adopt a pension plan or retirement plan that would have covered Mr. Smith. Thus, issues arising under an employment relationship as to the existence of an established plan are of no relevance to the circumstances where, as here, the severance pay is being paid to an independent outside director.) Questions arising under the federal conflict of interest laws have almost invariably involved issues pertaining to the severance of an employment relationship with an employee who is departing to enter public service. That, of course, was not the case with respect to Mr. Smith. To the contrary, Mr. Smith's relationship to the Company was that of an independent outside director, not an employee who was beholden to an employer for his salary (and principal source of earned income). Indeed, the relationship of an outside director to a publicly held company is, while fiduciary in nature, peculiarly one of independence, and is a relationship encouraged by the Securities and Exchange Commission in its concerns with corporate governance.

Indeed, the importance of the outside directors of a Board can hardly be overemphasized, particularly where, as here, Mr. Smith served as an attorney on the critically important Audit Committee. (The Company has approximately 2,000 employees; there were, in contrast, only five outside directors at the time of Mr. Smith's resignation).

A director, as is well established as a matter of common law, bears weighty fiduciary obligations to the corporation and its shareholders. The directors are charged with providing basic policy governance of the corporation, and constitute the sole decision-making mechanism which is elected by the shareholders. It is, ultimately, the sound judgment of the directors in electing officers and supervising the activities of the corporation to which the corporation and its shareholders must look for success. That role, as contrasted to the role of an employee, is critical to the long-term welfare of the corporation. Of particular significance in this instance is the fact that Mr. Smith brought to the Company's Board of Directors a range of experience gained from his service on several other important boards of directors.

The importance of that role is magnified significantly when, in addition to the wide-ranging duties of the corporate director, the individual is chosen by the Board to serve, in this instance with only two other directors of a 15-member board, as a member of the Board's Audit Committee. The uniqueness of a director's contribution to the corporation is particularly evident where, as here, Mr. Smith served as the only lawyer-member of the Audit

Committee, with the additional responsibilities attendant to the role.

In sum, there are simply no indicia of intent, which is of course the critical inquiry under Section 209, by the Board to do anything other than compensate Mr. Smith for his prior services. Indeed, we are advised that the transaction was entered into after the Company received advice from its outside counsel with respect to this transaction.

The intent of Mr. Smith as the recipient of the lump sum severence payment is equally clear. Mr. Smith's sole relationship to the Company was that of director and shareholder; he has never received compensation for services as an employee of the Company. Indeed, throughout his entire professional career, Mr. Smith has at no time been an employee of a for-profit corporation; rather, he has, as previously indicated, served for many years as a partner (including as a senior partner and member of the management committee and executive committee) of the law firm of Gibson, Dunn & Crutcher. His principal source of earned income at the time of this payment, as disclosed on his Financial Disclosure Report dated January 2, 1981, was the law firm of Gibson, Dunn & Crutcher.

Nor did Mr. Smith's resignation from Gibson, Dunn & Crutcher entail a loss of all law firm income. To the contrary, he continues to derive payments from vested benefits in the law firm's retirement plan, and he reported such income accordingly on his current Disclosure Report. As likewise revealed by his January 1981 Disclosure Report, Mr. Smith derived substantial income from assets which were transferred in 1981 to a qualified diversified trust established pursuant to the Ethics in Government Act. Mr. Smith's financial circumstances plainly show that a lump sum payment by a non-employer for prior services rendered as an outside director and paid by a corporation by which he had never been employed was in no manner intended by him as compensation for services subsequently rendered as an officer of the Executive Branch.

I would be pleased to provide your office with any further information that would be of assistance.

Sincerely,

Kenneth W. Starr
Counselor to the
Attorney General